

ZIMBABWE EZEKIEL GUTI UNIVERSITY



DEPARTMENT OF ACCOUNTING AND FINANCE

B. COM ACCOUNTING

COURSE: SPECIFIC FINANCIAL REPORTING

COURSE CODE: CAC405

12 JUNE 2018

DURATION: 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. No cell phones are allowed in the examination venue.
2. Answer **ALL FOUR** questions
3. Begin each question on a new page.
4. The number of marks allocated to each question or part question is shown in brackets
5. All questions carry twenty five marks each.
6. Hand-held, self-powered, non-programmeable, silent calculators are allowed into the examination.

Question 1

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* sets out the requirements for recognising as income any grants received from government agencies, together with any repayments of such grants.

- a) On 1 January 2014, Gumbochuma Ltd (Gumbochuma) applied to a government agency for a grant to assist with the construction of a factory in Lupane. The proposed construction cost of the factory was \$52 million and the company projected that 350 people would be employed on its completion. Gumbochuma already owned the land.
- b) On 1 March 2014, the government agency offered to grant a sum amounting to 25% of the factory's construction cost to a maximum of \$13 million. The grant aid was to be payable on completion, and would be repayable on demand if total employment at the factory fell below 300 people within 5 years of completion.
- c) At the financial year-end, 31 March 2014, Gumbochuma had accepted the offer of grant aid, and had signed contracts for the construction of the factory at a total cost of \$52 million. Construction work was due to commence on 1 April 2014.
- d) By 31 March 2015, the factory had been completed on budget, 400 people were employed ready to commence manufacturing activities, and the government agency agreed that the conditions necessary for the drawdown of the grant had been met.
- e) On 1 April 2015, the factory was brought into use. It was estimated that it would have a ten-year useful economic life. On 1 June 2015, the government agency paid over the agreed \$13 million. In addition, the company sought and was paid an employment grant of \$1.2 million as employment exceeded original projections. This is expected to be payable annually for 5 years in total, at a rate of \$12,000 per additional person employed over 300 in each year. There are no repayment provisions attached to the employment grant. The directors of Gumbochuma expect employment levels to exceed 350 people for at least 4 further years from 31 March 2016.

REQUIREMENT:

- (a) Detail the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* with respect to government grants to aid capital expenditure. Your answer should cover the initial recognition and subsequent treatment of these grants. (9 marks)
- (b) Discuss, showing calculations and journal entries where relevant, how Gumbochuma Ltd should record the above transactions and events in its financial statements for years ended 31 March 2014, 2015 and 2016. (11 marks)
- (c) Advise what accounting adjustments which would be necessary should it become apparent at 31 March 2017, that employment at the factory would soon drop below 300 people. (5 marks)

[Total: 25 MARKS]

Question 2

Many accounting standards require or permit the use of fair values in measuring assets and liabilities. However, there has not always been consistency between these standards regarding the method of arriving at fair value. IFRS 13 *Fair Values* was issued in May 2011 as an attempt to remedy this problem. The IFRS aims to define fair value, sets out a framework for measuring fair values, and standardises disclosures about the use of fair values by entities in their financial statements. It does not attempt to give guidance regarding the use of the resulting fair value figures, leaving this to the relevant standard dealing with the asset or liability in question. IFRS 13 makes it clear that fair value is market-based as opposed to being entity-specific. Hence the intentions of an entity regarding an asset or liability are not relevant when determining fair value.

Kutonga Ltd is an investment company, which holds a portfolio of securities linked to the real-estate market in Bindura. The following information is available at 31 July 2013 regarding this portfolio:

- i) The portfolio cost \$13 million 2 years ago.
- ii) Real-estate prices in Bindura are generally accepted to have dropped by 20-30% in the past 2 years.
- iii) The portfolio of securities held by Kutonga is difficult to value, as there is no active market. However, it has received an offer of \$2.6 million for this

portfolio from an investor. It has no intention of accepting this offer although some similar companies have accepted offers from this investor due to financial difficulties.

- iv) A normal sale in the present climate could be reasonably expected to yield \$6 million, based on an analysis of transactions in similar assets.
- v) Kutonga's valuation models suggest that the real estate market in Bindura will recover, and it expects that the portfolio will generate \$12 million (at present value) over the next three years.

REQUIREMENT:

- (a) Discuss the meaning of the term the term "Fair Value" as defined by IFRS 13 *Fair Values*. (9 marks)
- (b) Outline the 3-level hierarchy proposed by IFRS 13 to evaluate informational inputs into the measurement of fair values. (8 marks)
- (c) Advise the amount at which Kutonga Ltd should state its investment portfolio in its financial statements to 31 July 2013, assuming it wishes to use fair value as measured in accordance with IFRS 13 principles. (8 marks)

[Total: 25 MARKS]

Question 3

Mabhachi, a public limited company, operates many of its activities overseas. The directors have asked for advice on the correct accounting treatment of several aspects of Mabhachi's overseas operations. Mabhachi's functional currency is the dollar.

- a) Mabhachi has created a new subsidiary, which is incorporated in the same country as Mabhachi. The subsidiary has issued 2 million dinars of equity capital to Mabhachi, which paid for these shares in dinars. The subsidiary has also raised 100,000 dinars of equity capital from external sources and has deposited the whole of the capital with a bank in an overseas country whose currency is the dinar. The capital is to be invested in dinar denominated bonds. The subsidiary has a small number of staff and its operating expenses, which are low, are incurred in dollars. The profits are under the control of Mabhachi. Any income from the investment is either passed on to Mabhachi in the form of a dividend or reinvested under instruction from Mabhachi. The subsidiary does not make any decisions as to where to place the investments.

Required:

Mabhachi would like advice on how to determine the functional currency of the subsidiary. (7 marks)

- b) Mabhachi has a foreign branch, which has the same functional currency as Mabhachi. The branch's taxable profits are determined in dinars. On 1 May 2013, the branch acquired a property for 6 million dinars. The property had an expected useful life of 12 years with a zero-residual value. The asset is written off for tax purposes over eight years. The tax rate in Mabhachi's jurisdiction is 30% and in the branch's jurisdiction is 20%. The foreign branch uses the cost model for valuing its property and measures the tax base at the exchange rate at the reporting date.

Required:

Mabhachi would like an explanation (including a calculation) as to why a deferred tax charge relating to the asset arises in the group financial statements for the year ended 30 April 2014 and the impact on the financial statements if the tax base had been translated at the historical rate. (6 marks)

- c) On 1 May 2013, Mabhachi purchased 70% of a multi-national group whose functional currency was the dinar. The purchase consideration was \$200 million. At acquisition, the net assets at cost were 1,000 million dinars. The fair values of the net assets were 1,100 million dinars and the fair value of the non-controlling interest was 250 million dinars. Mabhachi uses the full goodwill method.

Required:

Mabhachi wishes to know how to deal with goodwill arising on the above acquisition in the group financial statements for the year ended 30 April 2014. (6 marks)

- d) Mabhachi took out a foreign currency loan of 5 million dinars at a fixed interest rate of 8% on 1 May 2013. The interest is paid at the end of each year. The loan will be repaid after two years on 30 April 2015. The interest rate is the current market rate for similar two-year fixed interest loans.

Required:

Mabhachi requires advice on how to account for the loan and interest in the

financial statements for the year ended 30 April 2014. (6 marks)

Mabhachi has a financial statement year-end of 30 April 2014 and the average currency exchange rate for the year is not materially different from the actual rate.

Exchange rates

\$1 = dinars

1 May 2013

5

30 April 2014

6

Average exchange rate for year ended 30 April 2014

5.6

Required:

Advise the directors of Mabhachi on their various requests above, showing suitable calculations where necessary. (25 marks)

Question 4

You are employed as the financial accountant for Moyomuti Ltd, an Irish manufacturing company located in Donegal. The financial controller, Paul Clancy, has asked you to advise him on matters relating to interim financial reporting. You have recently returned from a one-day training course on IAS 34 *Interim financial reporting*, and are keen to show Paul how much you have learned.

Required:

Write a memorandum to the financial controller, which covers the principles to be observed when preparing interim financial reports, as per the provisions of IAS 34 *Interim financial reporting* as well as the minimum contents of an interim financial report.

(25 marks)

*****END OF PAPER*****